

II. Management Discussion and Analysis

The first major requirement of GASB Statement 34 is the **Management Discussion and Analysis (“MD&A.”)** The purpose of an MD&A is a discussion, in laymen’s terms, of current year results in comparison with the prior year. As required supplemental information, (“RSI,”) the MD&A has procedures attached to it as part of the entity’s audit. The work is streamlined and includes only what is in Statement on Auditing Standards Number 52 (AU 558, paragraph 7). Additional audit work may be required upon the release of the AICPA State and Local Government Audit Guide, due in April 2001. Should you have questions on the audit of the MD&A, please talk to your external auditor. A comparison with the prior year is *not required* in Statements 34. However, certain calculations may need to be done to derive beginning balances for the new format of the statement of cash flows. Some of this information may be useful to disclose in your MD&A.

a. What an MD&A isn’t

An MD&A *should not be confused with a transmittal letter.* An MD&A is required for an entity’s General Purpose Financial Statements (“GPFS”) to conform to generally accepted accounting principles. A transmittal letter is a separate and distinct section of a CAFR that is not subject to audit. Paragraph 294 of GASB Statement 34 explains the Standards Board’s reasons why they have two different purposes.

b. What should be included in an MD&A

An MD&A is written from an objective point of view and it receives audit coverage as Required Supplementary Information (“RSI.”) It should be easy to read, and describe what has happened during the course of the year **utilizing charts and graphs instead of long, verbose statements.** Included in the MD&A should be the following:

- A description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position (net assets) or results of operations (revenues, expenses, and other changes in net assets.)

The discussion should be based on events or decisions that *have already occurred, or have been enacted, adopted, agreed upon or contracted.* Component units should not discuss in the MD&A the *possible* effect of events that *might* happen (although such matters could be addressed in the letter of transmittal in a CAFR.) The award and acceptance of a major grant, the adjudication of a significant lawsuit, an approved increase in a component units rates and a renegotiated labor contract with employees are a few examples of facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations and thus, might be discussed in the MD&A. Conversely, predicting that an ERP system under construction “will pay for itself” over a certain period of time would be an example of a statement that

is *not* based on currently known facts, decisions, or conditions.¹ Other topics may include:

- A short and long-term view of the component unit's activities—'where we are and where we are going.'
- A comparison of current year results with those of the prior year, with emphasis on the current year, highlighting **both positive and negative results**. This is a perfect place for charts and graphs.
- A focus on the component unit. Within that focus, discuss what is material. For those component units with underlying component units, there should be a clear distinction between financial results of the primary unit versus those of the component unit entity.
- A tailored discussion of only the most recent and relevant information – insuring that the format is not “boilerplate” and that old information is not carried forward from the prior year.

Paragraph 11 in Statement 34 has an itemization of what should be included as a minimum. That information is included as an appendix to this guide. (See Appendix D.)

Remember, because the MD&A is RSI, it has procedures of analysis in conjunction with the financial statements. If your organization decides not to include the MD&A, or it differs materially from the rest of the audited financial statements, SAS 52 prescribes that an explanatory paragraph is required for inclusion in your audit opinion.² In order for the Commonwealth to maintain an unqualified opinion, your component unit must receive an unqualified opinion.

The authorship of the MD&A is important. To implement this Statement properly, the management of your entity and / or your staff must write the MD&A and your external auditors must perform their audit procedures on of that information.

¹ *Guide to Implementation of GASB Statement 34 on Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments – Page 4. Question 13.* Government Accounting Standards Board, 2000.

² Statement on Auditing Standards number 52, as codified in Section AU 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor – Submitted Documents*. December, 1980. Also referenced in Section AU 558, paragraph 8, *Required Supplementary Information*. April, 1988.